

Senate Finance Committee

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Finance Committee Briefing



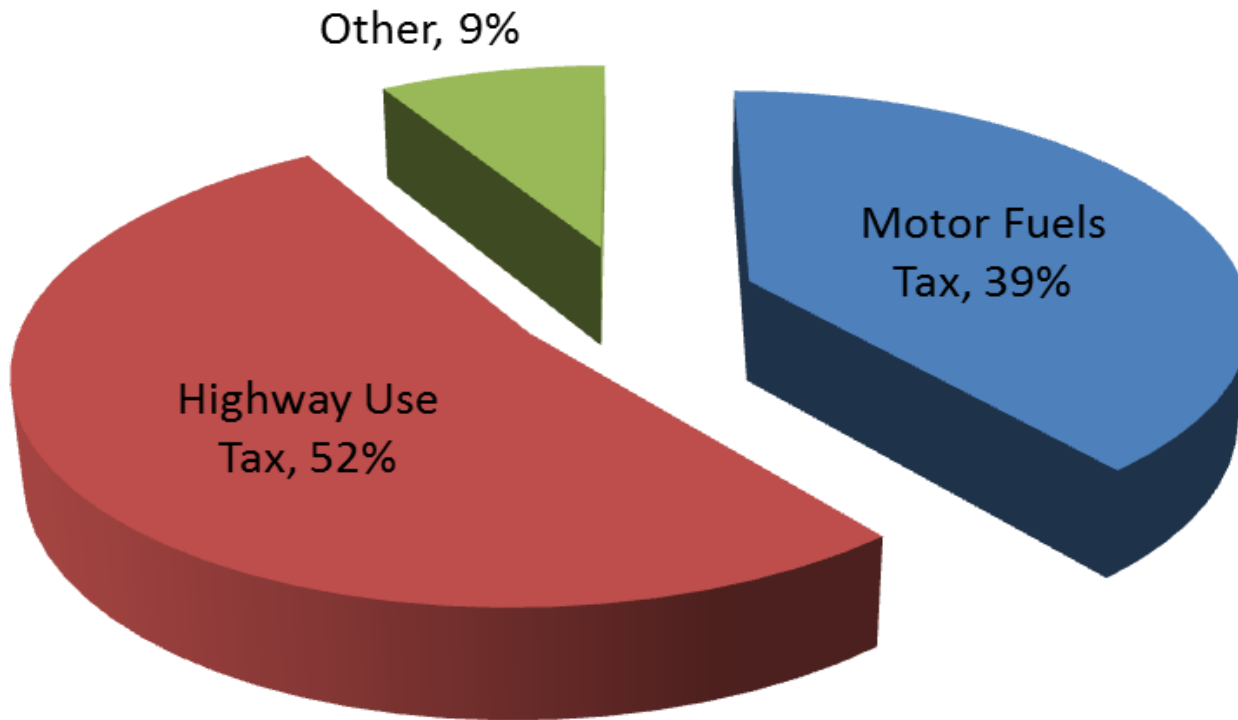
- Overview of North Carolina's Tax Structure
 - Highway Trust Fund Revenue Sources
 - Highway Fund Revenue Sources
 - General Fund Revenue Sources
- Overview of Economic Development Programs
 - Historical Perspective
 - Recent Philosophical Shifts
 - Current Programs

North Carolina's Tax Structure



HIGHWAY TRUST FUND
HIGHWAY FUND
GENERAL FUND

Highway Trust Fund



FY 2014-15

\$1.2 billion

Highway Use Tax



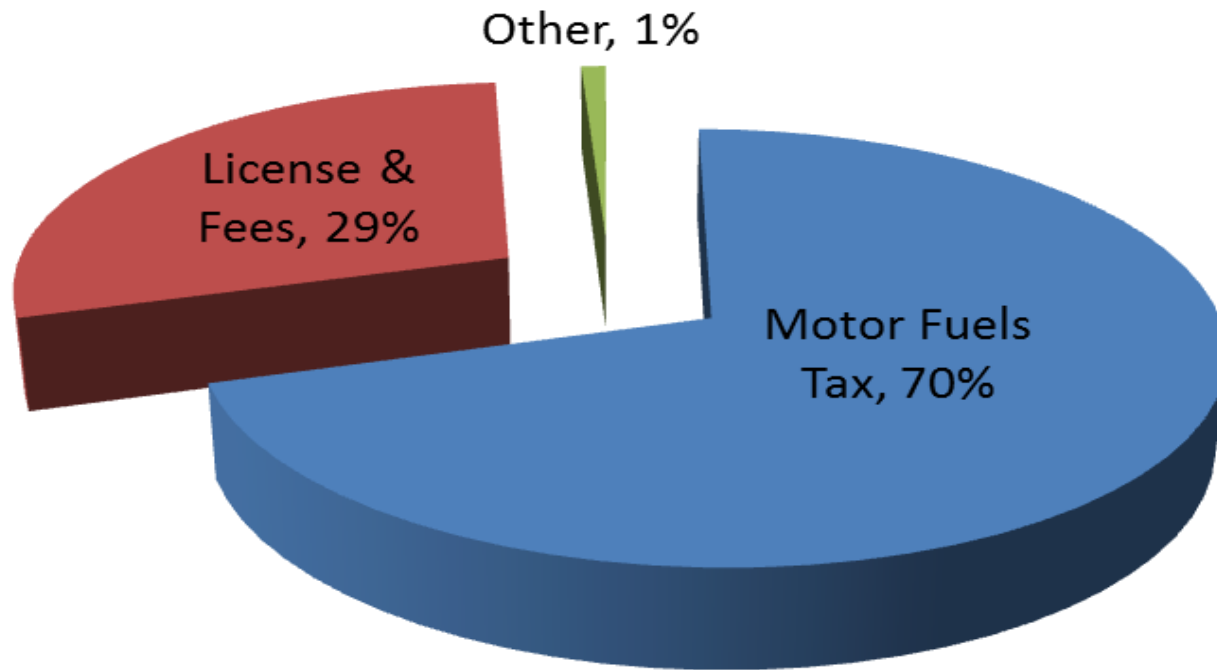
Tax Base

- Imposed when a certificate of title is issued
- Retail value of the vehicle
 - Sales price
 - Dealer administrative fees (October 1, 2014)

Tax Rate

- Three percent (3%)
 - Maximum tax of \$1,000 for Class A or Class B commercial vehicle
 - Maximum tax of \$1,500 for recreational vehicle
- Alternative tax for leased vehicles
 - 3% for long term rental (365 days or longer)
 - 8% for short term rental (remit to General Fund)

Highway Fund



FY 2014-15

\$2 Billion (e)

Motor Fuel Excise Tax



- **Tax on Motor Fuel**
 - Special purpose tax, Article V, Sec. 5 of the NC Constitution
 - “Tax at the Rack”
 - Current motor fuel excise tax rate of 37.5 cents
- **Tax on Alternative Fuel**
 - Same rate as the motor fuel excise tax rate
 - Allocated the same as the motor fuel excise tax proceeds
- **Tax on Motor Carriers**
 - IFTA (International Fuel Tax Agreement)
 - Same rate as motor fuel excise tax
 - Allocated the same as the motor fuel excise tax proceeds

Motor Fuel Excise Tax Rate

- Rate can move up or down twice a year
 - Fixed component of 17.5 cents
 - Variable component is the greater of:
 - ✦ 3.5 cents
 - ✦ 7% of the average wholesale price of motor fuel
- Rate has been capped 4 times since 2006

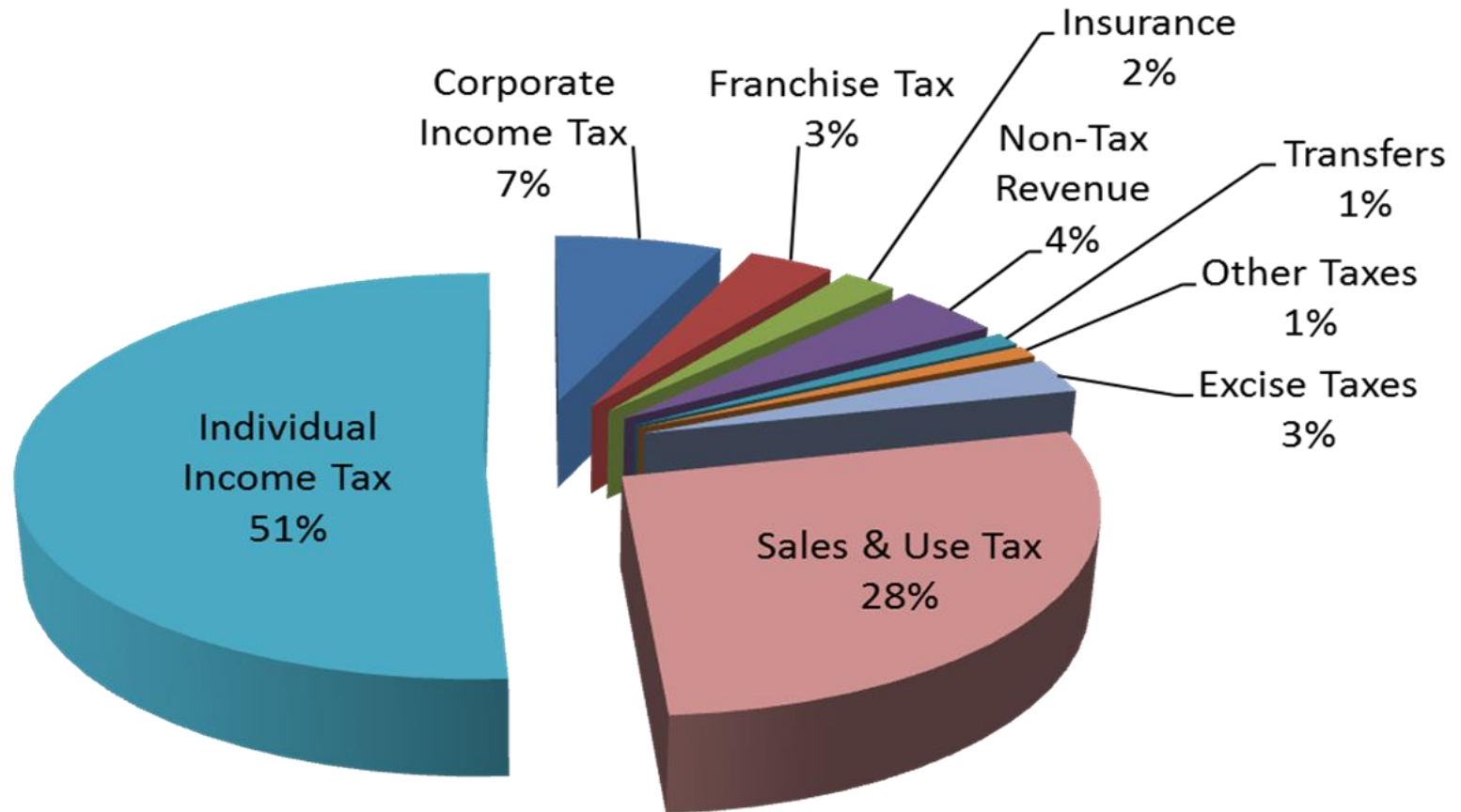


Allocation of Revenue



- 1/2 cent
 - Underground Storage Tank Fund
 - Water and Air Quality Account
- 25% - Highway Trust Fund
- 75% - Highway Fund
 - 1/6 of 1% to Wildlife Resources Fund
 - 1/6 of 1% to Shallow Draft Navigation Channel Dredging and Lake Maintenance Fund

General Fund



FY 2013-14

\$20.15 Billion

Personal Income Tax



- Start with federal adjusted gross income
 - 1989 – Federal taxable income
 - 2012 – Federal AGI
- Deductions
 - Social security
 - “*Bailey* retirement income, required by court order
 - Few others required : interest on bonds; decoupling
- Standard deduction or itemized deductions
 - Charitable giving
 - Home mortgage + Property tax on real estate, not to exceed \$20,000
- Child credit if AGI < \$100,000 (MFJ)
 - \$125 or \$100
- Flat rate of 5.75%

Corporate Income Tax



- Federal taxable income
- Deductions
 - Few required under federal law
 - Decoupling decisions
 - State net operating loss
- Rate of 5%
- Rate reduction trigger
 - FY14-15, \$20.2
 - FY15-16, \$20.975
 - Triggers not expected to be met
- Single entity state
 - Transactions lack economic substance
 - Transactions not at fair market value
- Apportion income
 - Multistate corporations
- Apportionment formula
 - Property
 - Payroll
 - 2x Sales (1988)

Economic Development



**YESTERDAY
AND
TODAY**



Incentive

Thing that motivates or encourages one to do something

A payment or concession to stimulate greater output or investment

- Prior to 1990s
 - NC University and Community College System
 - NC transportation system
 - NC low business costs and workforce
- Beginning in the 1990s
 - State undertook a specific effort to develop a program of economic development incentives
 - Response to perceived weakening competitive position with economic development in other states

Significant Strategy Shifts



- William S. Lee incentive program (1996)
 - Statutory tax credits
 - Article 3J
 - Other tax credits: Ports Charges, Interactive Digital Media, Renewable Fuels, Work Opportunity, Historic Rehabilitation, Low-Income Housing, Renewable Energy, NC Film Production, etc.
- Other income tax credit incentives and sales tax exemption/refund incentives
- Discretionary incentive programs (2002)
 - One North Carolina Fund
 - Jobs Development Investment Grant Program (JDIG)

Points Colliding



Tax Modernization Studies

- Tax rates too high compared to surrounding states
- Tax bases too narrow
 - Deductions
 - Exemptions
 - Credits
- Broaden the base, lower the rate

Evaluation of NC's Econ Dev Incentive Programs

- Statutory tax credits
 - Costs exceed discretionary spending costs
 - Not always tied to ED goals
- Discretionary programs
 - Strategic ED targeting
 - More effective than credits
- CIT rate reduction viable alternative to tax credits
- <http://www.ncleg.net/gascripts/DocumentSites/browseDocSite.asp?nID=29>



Tax Simplification and Tax Rate Reduction

S.L. 2013-316

S.L. 2014-3

- Broadened the income tax base
 - Eliminated no less than 40 exemptions, deductions, and credits
 - ✦ 2015: Film, Historic Rehab, Low Income Housing, Qualified Business Venture
 - ✦ 2016: Renewable Energy, Research & Development
- Lowered the income tax rates
 - Moved from graduated rate brackets to flat tax
 - CIT rate reduced from 6.9% to 5% (2015)
- Expanded the sales tax base
 - Amusements
 - Service contracts
 - Utilities
 - Eliminated exemptions

NC's Economic Development Inventory



- Prepared by Fiscal Research Division
- In FY11-12, NC devoted more than \$1.3 billion to economic development expenditures
- Five major expenditure categories
 - ✦ Tax expenditures = \$1.2 b
 - ✦ Grants = \$37 m
 - ✦ Support services = \$31 m
 - ✦ Pass-through = \$27 m
 - ✦ Transportation = \$6 m
- <http://www.ncleg.net/FiscalResearch/inventories/2012 edi 2013-03-11.pdf>



Reduced Corporate
Income Tax Rate

Eliminated Statutory Tax
Credits

Analyze Discretionary
Spending Programs

Evaluate Appropriations
that Specifically Target
Economic Development

<http://www.nccommerce.com/research-publications/incentive-reports>



**Next: A Closer Look at North
Carolina's Discretionary Spending
Programs**